


Office of Inspector General
U.S. House of Representatives
Washington, DC 20515-9990

MEMORANDUM

TO: Scot M. Faulkner
Chief Administrative Officer

FROM: John W. Lainhart IV 
Inspector General

DATE: July 18, 1995

SUBJECT: Audit Report -The House Beauty Shop's Management Controls Do Not Adequately Safeguard Assets Or Ensure Compliance With The Law (Report No. 95-CAO-21)

This is our final report on the internal controls of the Beauty Shop. The objective of this audit was to evaluate: (1) the adequacy of management controls; (2) compliance with applicable laws and regulations; and (3) any irregularities or illegal acts in the program area. In this report we identified noncompliance with laws and weak management controls and recommended corrective actions.

In response to our June 15, 1995 draft report, your office fully concurred with our findings and recommendations. The July 10, 1995 formal management response provided by the Director, Internal Controls and Continuous Improvement is incorporated in this final report and included in its entirety as an appendix. The corrective actions taken by your office are appropriate and should respond to the recommendations, provided that Beauty Shop services are contracted out. In addition, we have requested copies of policies and the latest cash reconciliation which support the implementation of the recommendations.

We appreciate your office's positive response and concurrence with the recommendations, and the courtesy and cooperation extended by your staff. If you have any questions or require additional information regarding this report, please call me or G. Kenneth Eichelman at (202) 226-1250.

cc: Speaker of the House
Majority Leader of the House
Minority Leader of the House
Chairman, Committee on House Oversight
Ranking Minority Member, Committee on House Oversight
Members, Committee on House Oversight

**THE HOUSE BEAUTY SHOP'S MANAGEMENT CONTROLS DO NOT
ADEQUATELY SAFEGUARD ASSETS OR ENSURE COMPLIANCE
WITH THE LAW**

Report No. 95-CAO-21

July 18, 1995

RESULTS IN BRIEF

CONCLUSIONS

The House Beauty Shop (HBS) has not established adequate accounting and operational controls to ensure that it is operating in compliance with existing laws and in accordance with sound management principles. Specifically, the HBS has not: (1) established budgetary and financial controls; (2) established effective cash management controls; (3) adequately safeguarded its automated system; (4) implemented effective inventory controls; (5) resolved a prior General Accounting Office audit finding; and (6) complied with other existing laws. As a result, the HBS's ability to effectively manage its operations and provide effective, timely, and accurate financial statements to management is diminished. Additionally, the HBS's cash and other assets are exposed to potential loss or misuse. These deficiencies are attributable primarily to the lack of development and implementation of clear and comprehensive policies and procedures.

RECOMMENDATIONS

We recommend that the Chief Administrative Officer (CAO) develop an action plan to correct the deficient balance of the HBS Revolving Fund and submit it for approval to the Committee on House Oversight. We also recommend that the CAO (1) establish budgetary and financial controls; (2) establish cash management controls; (3) implement adequate computer controls including user accountability and upgrade report capabilities; (4) develop and implement inventory controls; (5) establish an audit resolution process and; (6) clearly define, develop, and document policies and procedures to monitor compliance with existing laws. These recommendations are made contingent upon the HBS remaining under the jurisdiction of the House of Representatives. However, if the HBS is contracted out and depending on the level of control retained by the House of Representatives many of the recommendations may still be applicable.

MANAGEMENT RESPONSE

In his July 10, 1995 formal response to our draft report, the Director of Internal Controls and Continuous Improvement on behalf of the CAO stated general agreement with the findings and recommendations in this report. According to his response, a request has been made to the

Committee on Appropriations to authorize the use of appropriated funds to correct the deficient situation. In addition, the Committee on House Oversight on May 10, 1995 ordered the CAO to prepare a Request for Proposal for HBS services. The Request for Proposal was issued on June 28, 1995 with the contract award in August. Because of the pending award, some of the recommendations are not being implemented, while the others have been fully implemented.

OFFICE OF INSPECTOR GENERAL COMMENTS

We fully concur with the actions taken by the CAO and consider each recommendation closed unless the contract is not issued. In that event, those recommendations not implemented need to be addressed. In addition, we request documents that support the recommendations fully implemented. We commend the Office of the CAO on its prompt action with respect to the issues raised in this report.

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I. INTRODUCTION

Background

The House Beauty Shop (HBS), also known as the Cannon Salon, provides complete hair care to Members, congressional employees, and the public. During the period covered by our audit, October 1, 1993 to December 31, 1994, the HBS had eleven employees and was open Monday through Friday from 7:00 a.m. to 6:00 p.m. Since the manager's resignation in March 1995, the HBS has been open from 7:00 a.m. to 3:30 p.m. and employs five stylists, two manicurists, one esthetician, and a receptionist who also performs cashier duties. One beautician's employment terminated during the audit period.

House Resolution No. 423, One Hundred Second Congress, April 9, 1992 assigned operational and financial responsibility for the HBS to the Director of Non-Legislative and Financial Services, subject to the policy direction and oversight of the Committee on House Administration. House Resolution No. 6, One Hundred Fourth Congress, January 4, 1995 replaced the Director of Non-Legislative and Financial Services with the Chief Administrative Officer (CAO) and redesignated the Committee on House Administration as the Committee on House Oversight.

The Associate Administrator of Media and Support Services and the Deputy Director of Internal Controls and Continuous Improvement have been managing the HBS since the manager's resignation. These positions report to the Chief Administrative Officer. On May 23, 1995, the Committee on House Oversight authorized the CAO to issue, within 30 days, a request for proposal (RFP) to contract out the HBS. The RFP was issued on June 28, 1995 and the contract should be awarded in August.

The Legislative Branch Appropriation Act (Act), 1970, Public Law 91-145, 83 Stat. 347, enacted December 12, 1969, established a self-sustaining revolving fund in the Treasury consisting of the net assets and liabilities of the HBS on the day of enactment. All moneys received for services or any other source are deposited in the fund to be available without fiscal year limitation to pay for all expenses of the HBS. The expenses paid from the HBS Revolving Fund, therefore, are limited to the amount of capital transferred into the Fund on the date of enactment plus the amount of receipts deposited into the Fund minus expenditures, or the balance of the Fund.

The Act also requires that an adequate system of accounts be maintained and financial reports be prepared based on such accounts. The last financial statements for the HBS Revolving Fund, Fiscal Year (FY) 1993, audited by the General Accounting Office (GAO), reported assets totaling \$46,880; liabilities totaling \$35,330; revenues totaling \$283,947; and expenses totaling \$306,870. These totals do not include certain costs of the HBS which were financed through other funds appropriated to the U.S. House of Representatives. In addition, the Act requires the

net profit as established by GAO audit, after restoring any impairment of capital and providing for replacement of equipment, be transferred to the general fund of the Treasury.

Objective, Scope, And Methodology

Our objective was to evaluate: (1) the adequacy of management controls; (2) compliance with applicable laws and regulations; and (3) any irregularities or illegal acts in the program area. We identified and evaluated the HBS internal control structure through interviews with current and former HBS, Office of Finance, and House Information Systems (HIS) personnel; reviews of pertinent policies and procedures; observations of operations; reviews of management reports; and evaluation of the flow of transactions. Interviews with former HBS management and staff were limited because they were conducted subsequent to their employment with the U.S. House of Representatives. Our audit was conducted at the HBS and various sites, including the Office of Finance and HIS, and covers the period from October 1, 1993 to December 31, 1994. We also identified and reviewed subsequent events related to cash receipts and cash disbursements to satisfy requests from the Committee on House Oversight and the Chief Administrative Office's General Support and Special Services¹. We performed the audit from March through June 1995. The audit was made in accordance with *Government Auditing Standards* prescribed by the U.S. General Accounting Office and included such tests as we considered necessary in the circumstances.

Internal Controls

We reviewed internal controls related to the operation of the HBS. We found significant weaknesses in the following areas: (1) budgetary controls discussed in Finding A; (2) cash management discussed in Findings B and E; (3) computer controls discussed in Finding C; and (4) inventory controls discussed in Finding D.

Prior Audit Coverage

The GAO has routinely audited the accounts of the HBS and noted no material weaknesses in their reports. However, their audits for the periods ended 9/30/93, 9/30/92, 12/31/91, and 12/30/90 (during 1992, the HBS changed its fiscal year end from December 31 to September 30) indicated internal controls needed to be improved. Specifically, documentation requirements for retail sales were inadequate and periodic (monthly) reconciliations of cash between the HBS and the Office of Finance were not performed. (See Finding E for further discussion.)

In their report for the periods ended 9/30/93 and 9/30/92, dated April 1995, GAO reported the

¹General Support and Special Services has been reorganized into Media and Support Services.

HBS is not in compliance with the Legislative Branch Appropriation Act, 1970, Public Law 91-145, 83 Stat. 347. The cumulative net profit of \$16,531 established by the 9/30/92 and 12/31/91 GAO audit has not been transferred to the Treasury's general fund as required because the HBS Revolving Fund did not have the cash resources available at the time they were informed of the liability. The HBS remains liable for this amount, but still does not have the cash resources available to transfer the funds to the Treasury since the fund is deficient.

II. FINDINGS AND RECOMMENDATIONS

Finding A: HBS Revolving Fund Is Deficient

The HBS has been operating with a deficient monthly ending balance in the HBS Revolving Fund since May 1994. We were unable to determine why the HBS management did not sufficiently adjust or curtail operations prior to the fund becoming deficient. However, lack of budgetary controls; untimely, incomplete, and inaccurate financial information; and inadequate management response may have been factors.

Budgetary controls

Our audit did not identify any budgetary controls which ensured that the funds were available for disbursement prior to HBS management incurring an obligation or authorizing an expenditure. The Office of Finance prepares a manual general ledger which summarizes the HBS Revolving Fund's monthly financial activities and provides an ending fund balance. This report is mainly used by the Office of Finance to monitor the fund balance. It is available to HBS personnel upon request to reconcile HBS records with the Office of Finance. However, this report cannot be used as a budgetary control because it does not include obligations or provide a daily fund balance.

Untimely, incomplete, and inaccurate financial information

Prior to the implementation of the HBS computer in January 1994, the former HBS manager compiled daily revenues and expenses into biweekly reports and monthly spreadsheets which he distributed to the Director and acting Director of Non-Legislative and Financial Services. GAO used the HBS's spreadsheets to compile the yearly financial statements for the HBS Revolving Fund. According to the former HBS manager, GAO determined the HBS's ending inventory balance, cost of goods sold, and necessary accruals, before auditing the financial statements. GAO's financial audit report for the HBS Revolving Fund for the year ending 9/30/93 showed an operating loss of \$22,923. This report was issued April 1995. Reliance upon GAO to compile and report on the HBS's financial condition does not provide HBS management with timely information for making economic decisions.

After the computer system was implemented in early January 1994, the former HBS manager produced computerized biweekly commission and monthly financial reports based upon the data entered. Although the HBS's fiscal year is October 1 through September 30, monthly financial reports included the year-to-date operating profit and loss generated by the computer, i.e., only from early January 1994 through September 1994. The financial statements, however, should also include the HBS's profit or loss for the period October 1, 1993 to early January 1994. In addition, the HBS's computer system does not provide complete financial information such as a

statement of financial position. (See Finding C for further details on the computerized financial statements.)

Our review of the financial statements generated by the HBS computer system for January 1994 through December 1994 identified several inaccuracies. First, the statement for February 1994 reported March 1994 data. HIS personnel could not explain why this error occurred. Second, retail and shop expenses for May 1994 and June 1994 were reported as negative amounts. According to HIS personnel, the computer calculates these amounts by multiplying the quantity by the cost for all inventory entered during the month. HIS personnel stated the only method to correct an overstated quantity on hand is to enter a negative amount of inventory received. Therefore, if the former HBS manager entered quantities received as negative amounts in error or to correct a balance, the computer reported negative expenses. Third, commission expenses reported on the financial reports were understated because the computer included only commissions for periods which began and ended during the same month but not those which began in one month and ended in the next. HIS personnel corrected this programming error in March 1995, but the correction has not been made to the HBS's computer system. Finally, monthly payroll expenses were inaccurate. This information had to be entered monthly by the former HBS manager from reports provided by the Office of Finance. Otherwise, the computer system carries forward the previous month's totals. Payroll benefits were not correctly reported for eleven of the twelve months reviewed, and stylists' payroll expenses were not adjusted to reflect monthly adjustments for leave taken without pay.

Inadequate management response to cash flow problems

Copies of the monthly financial statements reporting HBS's operating losses were distributed, according to the former HBS manager, to all cognizant management. These officials approve the HBS's policies and procedures, including those related to employment and pricing. The former HBS manager also stated he sent letters to management in 1993 regarding expected monetary losses. He asserted that before the fund became deficient, management did not make appropriate changes to existing policies which might have increased revenues, such as increasing the HBS prices or allowing the HBS to advertise publicly. Our review of HBS files identified a request by the Office of the Director of Non-Legislative and Financial Services to the former HBS manager to provide operating reports every week beginning the first week of September 1994. This information was requested so the Office could "keep track of the salon's money situation on an on-going basis." We could not determine whether further actions were taken as a result of this request. Management is currently withholding payments to the HBS vendors for inventory

received; identifying sources of funds to bring the accounts current; and trying to privatize or contract out the HBS.

Recommendations

We recommend that the Chief Administrative Officer develop an action plan to correct the deficient balance of the HBS Revolving Fund and submit it for approval to the Committee on House Oversight. We also recommend that the Chief Administrative Officer:

1. Develop, implement, and utilize budgetary controls which ensure that funds are available for obligation or expenditure before they are authorized.
2. Ensure that financial information is timely, complete, and accurate to assist in making sound business decisions.
3. Implement policies for adequate segregation of functions which separate operational responsibility from record-keeping responsibility.

Management Response

In his July 10, 1995 formal response to our draft report, the Director of Internal Controls and Continuous Improvement, on behalf of the CAO, stated general agreement with the finding and recommendations. A request has been made to the Committee on Appropriations to authorize use of appropriated funds to correct the deficient situation. In addition, a RFP to contract for HBS services has been issued with the contract award in August. The Office of Internal Controls and Continuous Improvement will supervise the record keeping until the contract is awarded.

Office of Inspector General Comments

The CAO's actions are responsive to the issues we identified and satisfy the intent of our recommendations unless the contract is not awarded. In that event, those recommendations not implemented need to be addressed. We consider the recommendations closed contingent on the issuance of the contract.

Finding B: Cash Management Controls Need Improvement

The HBS needs to improve internal controls governing cash management. Our audit identified the following weaknesses: (1) all employees have access to cash in the computerized register; (2) cash receipts are adjusted to agree with recorded revenues; (3) adequate documentation related to cash either is not readily available, does not exist, or is incomplete; (4) not all sales revenues and commission expenses are recorded; and (5) not all sales revenues and shop expenses are recorded timely. These weaknesses occurred, in part, because the HBS's policies and procedures manual did not clearly communicate detailed guidance for handling specific transactions and the importance of these instructions; the HBS did not have adequate segregation of duties; and management did not perform independent reviews to ensure internal control objectives are being met. Consequently, management cannot be reasonably assured that cash is adequately safeguarded and their goals and objectives are being met.

Internal control structure

The internal control structure consists of management's policies, procedures, and commitment to reasonably prevent material errors and irregularities from occurring or going undetected. They are designed to provide management reasonable assurance that important goals and objectives are being met. Management is responsible for establishing and maintaining these policies and procedures. Typically, an effective internal control structure is designed to:

1. provide reliable data;
2. safeguard assets and records;
3. promote operational efficiency;
4. encourage adherence to prescribed policies; and
5. ensure compliance with applicable laws and regulations.

The controls adopted should be cost beneficial. The effectiveness of an internal control structure depends on the competency and dependability of the people using it. Careful and continuous review of control procedures is needed because personnel may forget, become careless, or intentionally fail to follow procedures. To encourage compliance and promote operational efficiency, policies and procedures should be clearly written and readily available. An effective policy and procedures manual should include job descriptions detailing the responsibilities of each position in the organization, management's instructions for processing specific transactions, sample copies of forms and documents, and a copy of the organization's code of conduct.

Physical access to cash

All HBS employees have a computer sign-on capability that allows them to enter their beginning and ending work times. This capability also allows the employees to enter sales transactions and access the cash register if the cashier is unavailable.

The assets of an organization can be stolen, misused, or accidentally destroyed if they are not properly protected by adequate controls. Management's internal control procedures must protect against any unauthorized access to or unauthorized disposal of assets. Controls over cash are particularly important because cash appeals to virtually everyone and is relatively easy to steal if not properly secured. Limiting the actual physical availability to cash is an important measure for preventing unauthorized access.

Allowing all HBS employees access to the cash register decreases accountability and increases the risk of defalcation. To strengthen controls over cash, management should limit access to recording sales and the cash register to only a few authorized employees.

Cash for deposit is adjusted to agree with recorded revenues

The HBS computer does not allow a transaction to be adjusted or voided after it is entered. To correct errors in recorded revenues, HBS personnel adjusted the sales transactions or the cash receipts the following work day. For example, if the cash in the register is over the recorded revenue amount, the cashier compares the customer sales tickets with the recorded daily summary sales totals for each stylist to identify any sales transactions not recorded. For all identified unrecorded sales, the corresponding receipts are withheld from the daily deposit. These sales are recorded the next business day, with the corresponding receipts included in that day's deposit. If the cash in the register is under the recorded revenue amount, the cashier compares the customer sales tickets with the summary sales totals to identify any sales recorded twice. This incident may occur when the cashier is away from the desk, returns, and records a sale that a stylist has already entered. To correct the error, the cashier does not complete the daily deposit until the following work day. Then, to correct a sale identified as recorded twice, the cashier does not record a sale of equal amount for that stylist, adds the receipt to the previous day's deposit, and completes the deposit slips for the two days. Usually every two to five work days, the HBS deposits the daily receipts with the Office of Finance which is located directly across the hall from the HBS. The Office of Finance accepts deposits between the hours of 11:00 a.m. and 1:00 p.m. and deposits all House receipts with the U.S. Treasury.

Internal controls should provide that key duties and responsibilities in authorizing, processing, recording, and reviewing transactions be segregated among individuals to protect cash from unauthorized disposal. When one person performs several functions, there is a greater risk that person may improperly dispose of the asset and adjust the records to conceal the

misappropriation. The cashier's practice of adjusting cash to agree with recorded revenues occurred because management's policies permit the person who has temporary custody of an asset to account for that asset, and all cash receipts are not deposited intact immediately. The HBS's method of correcting data entry errors reduces the integrity of the records and increases the risk of funds being misappropriated. The HBS should report cash shortages and overages when they occur and, at the end of the accounting period, report the net cash difference as either a miscellaneous expense or miscellaneous revenue.

Although the HBS has few employees which makes it more difficult to segregate duties, management could assign another employee with few scheduled customers to prepare and deposit all receipts daily. This division of duties, in which the work of one person is verified by another, discourages fraud and enables irregularities to be identified during the regular course of business. However, irregularities made through the collusion of two or more employees may not be identified.

Inadequate documentation and records

Several important HBS documents related to cash are not readily available, do not exist, or are not complete. Specifically, price lists authorized by the Committee on House Administration for services or retail products were not available; customer tickets were not written to document retail sales; and customer service tickets did not consistently include all pertinent information such as the service date, customer's name, service performed, and professional products used. In addition, no documentation exists to indicate that the HBS cash receipts and disbursements are reconciled with the Office of Finance's records. (Finding E provides further details on cash reconciliations.)

Adequate internal controls should provide that all transactions and other significant events be clearly documented and the documentation be readily available for examination. Adequate record keeping procedures must exist to ensure that management's internal control objectives can be met. Clear, readily available documentation for all transactions and other significant events facilitates accurate accounting for cash receipts. For example, several available services are entered in the HBS computer with various sales prices. Because an authorized service price list is not available, we could not verify, and management cannot be assured, that the sales prices entered in the computer and charged to the customer were accurate. Furthermore, HBS does not have a written policy for establishing retail inventory prices, therefore, the prices charged to the customer may not meet management's objectives. Finally, because customer service tickets lack

dates, customer tickets are not written for retail sales, and no independent reviews are performed, management cannot be assured that all customer sales and cash receipts are recorded.

Management should require that all transactions and other significant events be clearly documented and the documentation be readily available for examination.

Not all revenue and expenses recorded

The acting Director of Non-Legislative and Financial Services authorized the former HBS manager to hire an independent contractor on a trial basis. The independent contractor worked part-time without a written contract from November 1994 to February 1995. The HBS manager instructed the cashier not to record the contractor's sales in the HBS's computer system. Instead, the cashier was directed to place the unrecorded customer sales ticket and corresponding cash receipts in the manager's office. If the customer paid by check, the cashier put the check in the register for deposit and removed an equivalent amount of cash and included it with the customer sales ticket in the office.

In addition, the former HBS manager paid the independent contractor in cash. The independent contractor, who was paid on a commission basis only, stated his commission rate was 60% of his total sales. This pay structure differs from that of the other beauticians employed by the HBS who are paid a salary and 60% of their customer sales which exceed a management-established total for a biweekly period. The former HBS manager said he paid the independent contractor 50% of his sales and deposited the remaining cash in a separate deposit in January. He also stated that he terminated this arrangement after the change in the House administration. The contractor, however, continued to work into February according to the HBS's records. The HBS staff and the contractor estimate total revenues generated by the contractor were under \$1,000. Our review of the limited documents available indicates the amount was between \$600 and \$1,000. We reconciled the total HBS deposits recorded by the Office of Finance for January, February, and March 1995 with the total HBS daily cash drawer reports for these months. We were unable to identify the deposit made by the former HBS manager for the HBS's percentage of the independent contractor's sales.

The HBS's written policies and procedures do not identify comprehensive procedures for handling financial transactions. However, HBS personnel said that there were policies and procedures for recording customer sales and paying commissions. For example, to record sales the stylist completes a customer sales ticket after performing the required services. The customer then takes the ticket to the cashier and pays for the services and any retail products purchased. The cashier records the sale in the HBS computer and, generally at the end of each work day, completes a deposit ticket for sales revenue based on the computer's daily close out report. Deposits are kept in the HBS's safe usually two to five work days until remitted to the Office of Finance. Because the procedures for recording sales were not followed for the

contractor's sales, revenues were understated between \$600 and \$1,000.

To process commissions, the HBS manager prepares a report listing the gross amount earned by the stylists for a biweekly period, then completes and submits an authorized payment voucher to the Office of Finance. The Office of Finance reviews the voucher, calculates the net amount of pay, and enters the information into their computer system. After HIS generates checks payable to the stylists, the Office of Finance affixes the authorized signature, verifies the number of checks issued, and seals the envelopes. Finally, Postal Operations collects the sealed envelopes and mails them to the stylists. Cash payments to the independent contractor violated these procedures. Management's failure to follow established practices resulted in an understatement of commission expenses of between \$300 and \$600.

Not all revenues and expenses recorded timely

During our review of the internal control structure, we identified another instance where HBS management has not complied with their internal control procedures. We discovered this event as a result of the Committee on House Oversight's and General Support and Special Services' requests to review subsequent events related to cash receipts and disbursements.

The Associate Administrator of Media and Support Services and the Deputy Director of Internal Controls and Continuous Improvement have managed HBS operations since the resignation of the former HBS manager in March 1995. For its daily operations, the HBS maintained cash for the register drawer, a reserve for making change, and a petty cash fund. The petty cash fund was expended in 1994 and never replenished. After the balance of the HBS Revolving Fund became deficient in 1994, the Office of Finance curtailed payment of the HBS expenses other than employees' salaries and commissions. Consequently, the HBS was unable to maintain supplies necessary for its operations. To remedy this situation, on March 23, 1995, the Deputy Director of Internal Controls and Continuous Improvement authorized HBS personnel to use the change fund and revenue to be deposited for immediate operating expenses. Since March 1995, the HBS has periodically used funds from daily sales deposits to purchase supplies.

Management's authorization for HBS staff to purchase supplies from the change fund and revenues to be deposited circumvents the established internal control procedures for cash receipts and cash disbursements. Specifically, the HBS's procedures for payment of expenses require the manager to obtain an invoice from the supplier and then prepare and remit a voucher to the Office of Finance. The Office of Finance reviews and processes the voucher before paying the supplier.

To maintain accountability and limit the risk of misappropriation of funds, the HBS's disbursements should be made by the Office of Finance from an approved and authorized voucher. Currently, all HBS revenues and expenses are not being promptly recorded by the

Office of Finance, thereby understating HBS revenues and expenses for the period and reducing the reliability of financial information. Finally, management's overriding of established internal controls fails to encourage employees' adherence to prescribed policies and procedures.

Recommendations

We recommend that the Chief Administrative Officer:

1. Limit employees' access to the computerized cash register.
2. Ensure that the HBS deposits all cash receipts intact by 1:00 p.m. on the next work day.
3. Develop and implement policies for adequate segregation of functions which separate (a) the custody of assets from accounting; (b) the authorization of transactions from the custody of related assets; and (c) operational responsibility from record-keeping responsibility.
4. Develop a comprehensive manual that clearly identifies management's policies and procedures and provides detailed guidance for processing all transactions and other significant events related to cash management.
5. Ensure that documentation such as authorized service and retail price lists and completed customer tickets are maintained and readily available for examination.
6. Implement an independent verification policy which assures that management's internal control policies and procedures are effective and consistently being followed.

Management Response

In his July 10, 1995 formal response to our draft report, the Director of Internal Controls and Continuous Improvement, on behalf of the CAO, stated general agreement with the finding and recommendations. According to his response, corrective action for timely deposits of cash receipts and documentation of service and retail price lists have been fully implemented. In addition, access to the computerized cash register is limited to the person assigned to the reception desk. Also, the Office of Internal Controls and Continuous Improvement will supervise the record keeping and manage the custody of assets until the contract is awarded. Due to the pending contract award, a comprehensive manual will not be developed.

Office of Inspector General Comments

The CAO's actions are responsive to the issues we identified and satisfy the intent of our recommendations unless the contract is not awarded. In that event, the recommendation not

implemented will need to be addressed. We consider the recommendations closed contingent on the issuance of the contract.

Finding C. Computer Controls Need Improvement

Improvements are needed: (1) to prevent unauthorized access to records; (2) provide system and user documentation; (3) protect against loss of data; and (4) provide adequate accounting reports. These improvements are needed, in part, because HBS management did not adequately consider internal controls when designing and implementing their computer system. Consequently, management cannot be reasonably assured that vital records are accurate or adequately protected.

General computer controls

Management must have reliable information to make critical business decisions. Computerized systems often maintain this information. To safeguard assets and protect errors from occurring in the entity's records, internal controls established for computerized accounting systems should generally include:

1. physical controls over the assets and records;
2. proper authorization of transactions and activities; and
3. adequate documents and records.

Computer passwords

All HBS employees are required to record their starting and ending work times on the HBS's computer system. Therefore, all employees have access to the computer. The employee enters his/her first name from a list of displayed user logons to obtain access. Once any employee logs on, all other employees may log on, record their starting and ending times, or enter sales and services transactions. The cashier's log on permits additional access to a daily close out report. Only the former HBS manager was required to enter a password to access the system. The password allowed the manager to change files and generate reports.

Passwords are used to prevent unauthorized users from accessing and changing restricted records. Every transaction must be properly authorized if controls are to be satisfactory. Because the HBS employees, other than the former manager, were not required to enter passwords, there is no control to prevent one employee from recording the starting or departure time for another. Furthermore, the system does not allow the employee to record any leave taken during the day, therefore, there is no assurance that the computer's report of employees' total hours worked is accurate. In addition, employees may access all computer capabilities available to the first employee who logged on to the system. Consequently, if the former manager was logged on to the system under his password, all employees could access any of the computer options including changing data files.

Computer documentation

The HBS has minimal documentation for its computer system. This system was purchased in 1991 but not used until January 1994. To facilitate use by the HBS personnel, it was substantially modified by HIS between October 1993 and January 1994. According to HIS personnel, documentation does not exist for the HBS system because (1) HIS did not have the time necessary to write documentation; (2) the HBS computer is a stand-alone system and is not a high priority in HIS's workload; and (3) the frequency of changes requested by the former HBS manager made documentation difficult.

The lack of sufficient system documentation is an internal control weakness for two reasons. First, HIS programmers tasked with further modifications may not be familiar with previous modifications made. This increases the risk of new changes adversely affecting other areas or not working as intended. Second, insufficient documentation increases the cost of maintaining and updating the system because programmers need additional time to identify how the program works before further changes can be implemented. In addition, the lack of detailed documentation for entering transactions and generating reports is an internal control weakness because written user instructions help ensure all data is entered correctly and consistently.

Backup procedures

The former HBS manager stated he performed daily computer data backups. HIS personnel periodically copy HBS data files to answer user's questions and estimate backups can be completed in two to three minutes. However, we could not determine when the former HBS manager last performed a backup because the backup tapes stored in his office could not be read. HIS personnel determined that the new operating system installed on May 31, 1994 could not read or write to the tapes. HIS personnel explained that they did not test the backup procedure when they installed the new operating system. Instead, they presumed the former HBS manager would contact HIS if the system was not operating properly. HIS personnel concluded that backups were not performed since the new operating system was installed on May 31, 1994.

HBS management is responsible for establishing and performing backup procedures and developing a data recovery plan. Backup procedures protect against the risk of temporary hardware failures that may occur. A data recovery plan assists the organization in recovering its data processing capacity as smoothly and quickly as possible. The plan should include provisions for storing duplicate copies of critical files and programs in an off-site location.

Accounting reports

The HBS computer system cannot provide complete accounting reports, such as a general ledger trial balance or a statement of financial position. HIS did not include these reports in the computer options because beginning balances were not entered when the system was implemented. The system can compile a monthly statement of profit and loss if payroll information is received from the Office of Finance and manually entered.

Financial statements identify, measure, and communicate economic information to management and external users. Management customarily utilizes four basic, general purpose financial statements to decide how scarce resources should be allocated: the statement of position, the statement of profit and loss, the statement of cash flows, and the statement of retained earnings. The statement of financial position reflects the entity's solvency, or its ability to pay its debts when they come due, at a particular point in time. The statement of profit and loss reports the entity's profitability, or ability to generate earnings, over a period of time. The statement of cash flows summarizes an entity's cash receipts and cash payments during a period of time, and the statement of retained earnings describes the changes in an entity's retained earnings during a period.

Complete and accurate financial statements are needed by HBS management to help prevent the incurring of obligations or the making of expenditures in excess of amounts available in the HBS Revolving Fund.

Recommendations

We recommend that the Chief Administrative Officer:

1. Modify the HBS computer's logon procedures (a) to require all employees to enter a password when recording their starting and ending work times, and (b) to limit unauthorized access to record and change transactions.
2. Document the HBS computer system and provide this documentation to the user.
3. Establish and implement backup procedures and a data recovery plan.
4. Modify the HBS computer's financial reports subsystem to provide the capability of generating complete financial statements.

Management Response

In his July 10, 1995 formal response to our draft report, the Director of Internal Controls and Continuous Improvement, on behalf of the CAO, stated general agreement with the finding and recommendations. According to his response, HIS is performing daily backups of the HBS computer system. Due to the pending contract award, the other recommendations are not currently being implemented.

Office of Inspector General Comments

The CAO's actions are responsive to the issues we identified and satisfy the intent of our recommendations unless the contract is not awarded. In that event, those recommendations not implemented need to be addressed. We consider the recommendations closed contingent on the issuance of the contract.

Finding D: Inventory Controls Need Improvement

HBS personnel have unrestricted access to inventory supplies, and inventory records are insufficient. In addition, although the HBS implemented an automated perpetual inventory system in January 1994, periodic reconciliations of the computerized perpetual inventory reports with the physical inventory on hand have not been done. The inventory storage areas are available to all HBS employees for convenience, and the records are inadequate because of lack of detailed instructions. The former manager said he did not perform reconciliations because he was too involved operating the salon. Periodic reconciliations help prevent or identify the misappropriation of goods. Consequently, management cannot be assured that inventories are properly secured and records are accurate.

General inventory control procedures

Internal control procedures regarding inventory must be designed to give assurance that:

1. inventories are properly secured;
2. all valid purchase transactions are accurately recorded and processed; and
3. accurate records of inventories are maintained.

Inventory storage

Retail inventory is kept in locked display cases in the reception area. When the HBS carried a larger quantity of inventory, the cashier usually unlocked the cases at the beginning of the day and locked them at closing. Since current inventory quantity is low, the cases are only unlocked when a customer requests a product. The key for the inventory cases is kept in the reception area so employees can access the inventory when the cashier is unavailable.

Professional inventory used in salon operations is maintained in locked storage areas. The former manager, cashier, and one stylist had keys to the storage areas. Since the manager's resignation in March 1995, the stylist's key is available so that all HBS employees may access the professional supplies. Unrestricted access to these supplies lessens accountability and increases the risk of their misuse or misappropriation.

Recording procedures

HBS personnel do not complete customer sales tickets for retail products sold. Prior to January 1994, the cashier recorded retail product sales under one department code in the cash register. The cashier attached the cash register receipts to a manual spreadsheet divided into columns labeled with various manufacturers, such as Aveda and Paul Mitchell. The cashier then listed the sales amount under the appropriate manufacturer's name but did not identify the

individual product sold. Our review of retail documentation for the period October 1993 to January 1994 disclosed that all retail sales were not recorded on the spreadsheet, and the spreadsheet was not totaled or compared to the daily departmental total. As a result, this procedure did not effectively maintain an accurate record of retail products sold.

In January 1994, HBS implemented a computerized inventory system. At that time, the HBS counted the physical inventory. For each product on hand, the manager entered a description in the computer, i.e., retail or professional product, quantity, vendor, item cost, and resale price, where applicable. The manager entered this data as additional purchases were received. According to HBS personnel, retail prices were set by the former manager, but the HBS does not have detailed procedures for determining retail inventory prices.

Based on our review of available documentation, we determined that inventory was entered in the computer until 9/30/94. However, we were unable to determine whether all inventory received was included or whether the entered inventory was accurate. We could not determine the accuracy of the recorded inventory because (1) HBS personnel do not use receiving reports or sign and date the packing slip or invoice when items are received, (2) the former HBS manager did not sign and date supporting documentation to indicate the date the items were entered into the computer, and (3) the HBS computer reports the "in" date as the date the inventory was entered into the system, not when the items were received. Consequently, we could not confirm whether our sample of inventory items, taken from vendor invoices submitted for payment by the HBS manager, were completely and accurately entered.

Since January 1994, the cashier has been entering retail items and professional supplies when recording the sales transaction. These products are not included on customer service tickets. Therefore, the cashier had to ask the stylists what professional supplies were used in performing the service. The cashier said she stopped recording professional supplies because she believed the former manager had stopped entering purchases into the computerized inventory system. However, she could not remember when they stopped entering this information.

As part of the daily close out, the cashier prints a computerized list of the retail products sold. The report identifies the quantity and total dollar amount for each product sold, and a grand total for all retail products sold. This report is used to reconcile daily cash receipts with the reported cash register balance.

To reduce the risk of misappropriation of assets, the person who has access to the asset should not keep the inventory records. In addition, adequate supporting documentation such as receiving reports should be kept.

Inventory reconciliations

Counts of actual inventory quantities on hand should be reconciled on a regular basis with quantities recorded in the perpetual inventory report. Adequate control procedures should be established to ensure an accurate physical count. These procedures should include proper instructions for the physical count, supervision by responsible personnel, independent verification of the counts, and independent reconciliations of the physical counts with the perpetual inventory report. Periodic reconciliations of the HBS inventory are important to identify misappropriations, data entry errors, and incomplete inventory records.

The HBS manager did not perform periodic reconciliations between the computerized perpetual inventory report and the physical inventory on hand during 1994 because he said he was too busy operating the salon. Our review of inventory reports identified a substantial number of negative quantities on hand which could not be explained by HBS staff. In addition, HBS's inventory report does not sort and subtotal the inventory into retail items and professional products, provide the cost of the items purchased, or calculate aggregate cost of quantities on hand. For reliable and complete financial information and to facilitate inventory reconciliations, the report should include this data.

Recommendations

We recommend that the Chief Administrative Officer:

1. Ensure HBS management routinely performs periodic reconciliations of the computerized perpetual inventory reports with the physical inventory on-hand and adjusts the balances accordingly.
2. Develop and implement a retail inventory pricing policy and ensure this policy is readily available for examination.
3. Record professional inventory used on customer sales tickets and enter these products in the computer when recording customer sales.
4. Modify the HBS computer's inventory subsystem to provide: (a) the cost of items purchased; (b) the aggregate cost of quantities on hand; and (c) the subtotals for each class of inventory.

Management Response

In his July 10, 1995 formal response to our draft report, the Director of Internal Controls and Continuous Improvement, on behalf of the CAO, stated general agreement with the finding and recommendations. According to his response, corrective actions to develop and implement a retail inventory pricing policy and to record use of professional products used have been fully implemented. Due to the pending contract award, the other recommendations are not currently being implemented.

Office of Inspector General Comments

The CAO's actions are responsive to the issues we identified and satisfy the intent of our recommendations unless the contract is not awarded. In that event, those recommendations not implemented need to be addressed. In addition, we request a copy of the policies for retail inventory pricing and recording professional inventory used. We consider the recommendations closed contingent on receipt of the policies and the issuance of the contract.

Finding E: Further Actions Needed To Correct GAO-Identified Weakness

Cash reconciliations between the HBS and the Office of Finance records still are not being performed as noted in the GAO's audit reports on the HBS Revolving Fund². The former manager said he was too involved operating the salon to perform reconciliations and that his records did not correspond with those of the Office of Finance. Without routine reconciliations, management cannot be assured that cash is properly secured and misappropriations are identified.

Reconciliation of cash needed between the HBS and Office of Finance records

The GAO concluded in two previous reports that the HBS needed to improve certain internal controls including strengthening documentation requirements for retail sales and performing cash reconciliations with the Office of Finance. In response, HBS implemented an automated system in 1994 designed to record individual retail sales and to provide data for periodic reconciliations with the Office of Finance. Although the GAO noted control improvements in its last audit, it cited these two issues as continuing weaknesses. During our review, we determined that retail sales were now being adequately documented but cash reconciliations still were not being performed. (See Finding D for additional discussion.) The former manager said he did not reconcile cash or shop expenses with the Office of Finance records because he was too involved in trying to keep the HBS operational. Furthermore, HBS's records did not correspond with Finance's. Specifically, there were timing and classification differences between the HBS and Finance records which had not been adjusted, and HBS's records were incomplete. (See Finding A for further details.) Periodic reconciliations are a critical internal control technique which would help prevent or identify the misappropriation of funds.

Recommendation

We recommend that the Chief Administrative Officer ensure that monthly cash reconciliations between the HBS and Office of Finance records are performed and all discrepancies corrected.

²Financial Audit: House Beauty Shop Revolving Fund for the Year Ended 9/30/93 and 9 Months Ended 9/30/92 (GAO/AIMD-95-82, April 14, 1995); and Financial Audit: House Beauty Shop Revolving Fund for Periods Ended 9/30/92, 12/31/91, 12/30/90 (GAO/AIMD-93-42, September 13, 1993).

Management Response

In his July 10, 1995 formal response to our draft report, the Director of Internal Controls and Continuous Improvement, on behalf of the CAO, stated general agreement with the finding and recommendation. According to his response, corrective action for monthly cash reconciliations has been fully implemented.

Office of Inspector General Comments

The CAO's action is responsive to the issues we identified and satisfies the intent of our recommendation. We request a copy of the latest cash reconciliation performed between the HBS and Office of Finance records. We consider the recommendations closed contingent on receipt of the reconciliation.

Finding F: Noncompliance With Title 2, United States Code, Section 96 (2 USC 96)

Our review identified payments totaling \$991.98 made from the HBS Revolving Fund for barber shop supplies. These payments violate 2 USC 96 which prohibits the Clerk of the House from paying any bills for supplies used in the House barber shops. Furthermore, Public Law 91-145 provides that this Revolving Fund shall be used only for expenses of the beauty shop. The payments were authorized by the Committee on House Administration. However, these payments violate existing laws.

Federal law restrictions

Public Law 91-145 established the HBS Revolving Fund and provides that moneys in the fund shall be available without fiscal year limitation for disbursement by the Clerk of the House of Representatives for all expenses of the Beauty Shop.

Federal law 2 USC 96 states, "It shall be unlawful for the Clerk of the House to pay out of any moneys of the House of Representatives any bills for laundry, supplies, or utensils, except necessary furniture, used in the barber shops of the House Office Building or the House side of the Capitol."

HBS purchased barber shop supplies

In November 1993, House Barber Shop personnel prepared purchase order requests for shoe shine and barber shop supplies and forwarded them to the HBS. The former HBS manager ordered and received the supplies and sent them along with copies of the vendors' invoices to the House Barber Shop. The former HBS manager attached the original invoices to a payment voucher which was approved by the Director of Non-Legislative and Financial Services and submitted to the Office of Finance. On January 11, 1994, the Clerk, U.S. House of Representatives approved, and the Office of Finance paid, \$991.98 from the HBS Revolving Fund for the barber shop supplies. On January 14, 1994, the Office of Finance paid the barbers \$991.98 as additional compensation for out-of-pocket operating expenses for these supplies. The barbers, in turn, reimbursed the HBS for the supplies, and the HBS deposited the checks with the Office of Finance on February 8, 1994. Consequently, the Clerk paid for the barber shop supplies in violation of 2 USC 96.

During our audit, we reviewed a letter dated June 19, 1990, from the Committee on House Administration which authorized the Clerk of the House to disburse from the House Barber Shop Revolving Fund, as additional compensation to barber shop personnel, verifiable out-of-pocket hair and shoe care operating expenses. However, we were unable to locate authorization for the HBS to pay from and subsequently reimburse their own revolving fund for operating expenses related to the barber shop.

Recommendation

We recommend that the Chief Administrative Officer ensure that disbursements made from the HBS Revolving Fund are only for HBS expenses.

Management Response

In his July 10, 1995 formal response to our draft report, the Director of Internal Controls and Continuous Improvement, on behalf of the CAO, stated general agreement with the finding and recommendation. According to his response, corrective action ensuring that all HBS Revolving Fund disbursements are HBS expenses has been implemented.

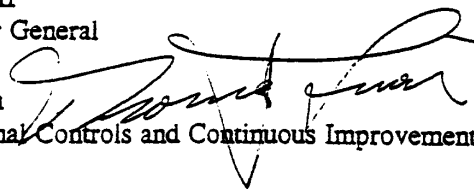
Office of Inspector General Comments

The CAO's action is responsive to the issues we identified and satisfies the intent of our recommendation. We request a copy of the procedure that will ensure that all HBS Revolving Fund disbursements are HBS expenses. We consider the recommendations closed contingent on receipt of the policy.

Office of the
Chief Administrative Officer
U.S. House of Representatives
Washington, DC 20515-6860

MEMORANDUM

TO: Robert B. Frey III
Deputy Inspector General

FROM: Thomas J. Simon 
Director of Internal Controls and Continuous Improvement

DATE: July 10, 1995

SUBJECT: Draft Audit Report - Beauty Shop

We appreciate the opportunity to comment on your draft report. We deeply appreciate your efforts and are in general agreement with the findings and recommendations. Specific comments on each recommendation follow. If there are any questions or additional information required regarding this reply, please contact me at (202) 226-1854.

Finding A

Recommendation : A request has been made to the Committee on Appropriations to authorize the use of appropriated funds to correct the deficient situation.

Recommendations 1 and 2: The Committee on House Oversight on May 10 ordered the CAO to prepare a Request for Proposal and contract for Beauty and Barber Shop services. The contract is scheduled for award in August. Daily records are currently being maintained and the financial position monitored until the contract is awarded.

Recommendation 3: The Office of Internal Control and Continuous Improvement is supervising the record keeping until contract award.

Finding B

Recommendation 1: Only the person assigned to the reception desk is allowed to operate cash register.

Recommendation 2: This recommendation has been fully implemented.

Recommendation 3: The Office of Internal Control and Continuous Improvement is supervising the record keeping and managing the custody of assets until contract award.

Recommendation 4: Because of the pending contract award this recommendation is not currently being implemented.

Recommendation 5: This recommendation has been fully implemented.

Recommendation 6: This recommendation has been fully implemented by having daily review by the Office of Internal Control and Continuous Improvement.

Finding C

Recommendation 1: Because of programing costs and the pending contract award this recommendation is not currently being implemented.

Recommendation 2: Because of costs and the pending contract award this recommendation is not currently being implemented.

Recommendation 3: HIR is backing up the files on a daily basis. Because of costs and the pending contract award no further action is planned.

Recommendation 4: Because of programing costs and the pending contract award this recommendation is not currently being implemented. However the system does currently produce profit and loss statements.

Finding D

Recommendation 1: Because of the pending contract award, no inventory is currently being maintained. Supplies are purchased on an as needed basis.

Recommendation 2: This recommendation has been fully implemented.

Recommendation 3: This recommendation has been fully implemented.

Recommendation 4: Because of programing costs and the pending contract award this recommendation is not currently being implemented.

Finding E

Recommendation: This recommendation has been fully implemented.

Finding F

Recommendation: This recommendation has been fully implemented.